

John Tolfree Health System Corporation and Subsidiaries

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**Consolidated Financial Report
with Additional Information
March 31, 2004**

John Tolfree Health System Corporation and Subsidiaries

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Independent Auditor's Report

Board of Trustees

John Tolfree Health System Corporation and Subsidiaries

We have audited the accompanying consolidated balance sheet of John Tolfree Health System Corporation and Subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of revenue and expenses and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of John Tolfree Health System Corporation and Subsidiaries at March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Corporation adopted the provisions of Governmental Accounting Standards Board No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments as of April 1, 2003.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 8, 2004 on our consideration of John Tolfree Health System Corporation and Subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Corporation has not presented the Management's Discussion and Analysis that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Plante & Moran, PLLC

June 8, 2004

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John Tolfree Health System Corporation and Subsidiaries

Consolidated Balance Sheet

		March 31	
		2004	2003
Assets			
Current Assets			
Cash and cash equivalents (Note 2)	\$	2,693,834	\$ 1,770,963
Accounts receivable (Note 3)		4,347,155	2,676,923
Cost report settlements receivable		632,400	750,000
Inventories		1,004,535	1,109,709
Other current assets		960,143	867,916
Total current assets		9,638,067	7,175,511
Assets Limited as to Use (Note 5)		7,870,658	10,598,355
Property and Equipment (Note 6)		29,574,662	31,090,288
Deferred Charges		318,846	335,197
Total assets		<u><u>\$ 47,402,233</u></u>	<u><u>\$ 49,199,351</u></u>
Liabilities and Net Assets			
Current Liabilities			
Current portion of long-term debt (Note 7)	\$	552,091	\$ 495,461
Accounts payable		1,488,197	1,710,883
Cost report settlements payable		-	124,601
Accrued liabilities		1,455,209	1,852,825
Total current liabilities		3,495,497	4,183,770
Deferred Revenue (Note 8)		4,110,332	4,227,213
Long-Term Debt (Note 7)		18,210,116	18,776,581
Total liabilities		25,815,945	27,187,564
Net Assets			
Invested in capital assets - Net of related debt		10,812,455	11,818,246
Unrestricted		10,773,833	10,193,541
Total net assets		<u>21,586,288</u>	<u>22,011,787</u>
Total liabilities and net assets		<u><u>\$ 47,402,233</u></u>	<u><u>\$ 49,199,351</u></u>

John Tolfree Health System Corporation and Subsidiaries

Consolidated Statement of Revenue and Expenses and Changes in Net Assets

	Year Ended March 31	
	2004	2003
Operating Revenue		
Net patient service revenue	\$ 35,074,593	\$ 33,381,271
Other operating revenue	2,438,879	1,912,607
Total operating revenue	37,513,472	35,293,878
Operating Expenses		
Salaries and wages	12,757,428	11,999,646
Fringe benefits	3,699,509	3,383,253
Supplies and other	10,761,986	10,992,185
Drugs	5,232,028	3,936,931
Professional fees	2,117,931	2,414,050
Depreciation and amortization	2,633,707	2,621,776
Total operating expenses	37,202,589	35,347,841
Income (Loss) from Operations	310,883	(53,963)
Nonoperating Revenue (Expenses)		
Unrestricted donations	82,884	94,601
Investment income	230,269	333,416
Interest expense	(1,049,535)	(1,090,494)
Net nonoperating revenue (expenses)	(736,382)	(662,477)
(Decrease) in Net Assets	(425,499)	(716,440)
Net Assets - Beginning of year	22,011,787	22,728,227
Net Assets - End of year	<u>\$ 21,586,288</u>	<u>\$ 22,011,787</u>

John Tolfree Health System Corporation and Subsidiaries

Consolidated Statement of Cash Flows

	Year Ended March 31	
	2004	2003
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 33,397,360	\$ 32,888,415
Cash paid to suppliers and employees	(35,175,440)	(32,164,239)
Other receipts from operations	2,185,782	1,681,034
Net cash provided by operating activities	407,702	2,405,210
Cash Flows from Noncapital Financing Activities		
Donations and memorials	194,521	169,728
Cash Flows from Capital and Related Financing Activities		
Purchase of property and equipment	(1,101,730)	(1,954,238)
Interest paid on long-term debt	(1,050,332)	(1,097,812)
Payments on long-term debt	(509,835)	(472,486)
Net cash used in capital and related financing activities	(2,661,897)	(3,524,536)
Cash Flows from Investing Activities		
Decrease in investments	2,731,949	477,028
Interest received	254,848	372,981
Net cash provided by investing activities	2,986,797	850,009
Net Increase (Decrease) in Cash and Cash Equivalents	927,123	(99,589)
Cash and Cash Equivalents - Beginning of year	5,617,635	5,717,224
Cash and Cash Equivalents - End of year	<u>\$ 6,544,758</u>	<u>\$ 5,617,635</u>
Composed of:		
Cash and cash equivalents	\$ 2,693,834	\$ 1,770,963
Assets limited as to use	3,850,924	3,846,672
Total	<u>\$ 6,544,758</u>	<u>\$ 5,617,635</u>

John Tolfree Health System Corporation and Subsidiaries

Consolidated Statement of Cash Flows (Continued)

	Year Ended March 31	
	2004	2003
Reconciliation of Income (Loss) from Operations to Net Cash Flows Provided by Operating Activities		
Income (Loss) from operations	\$ 310,883	\$ (53,963)
Adjustments to reconcile income (loss) from operations to net cash provided by operating activities:		
Depreciation and amortization	2,633,707	2,621,776
Noncash rental income	(116,881)	(116,881)
Contributions included in operations	(98,846)	(73,437)
Interest income included in operations	(37,370)	(41,255)
Provision for doubtful accounts	835,214	947,756
(Increase) decrease in assets:		
Accounts receivable	(2,505,446)	(264,414)
Cost report settlements receivable	117,600	(750,000)
Inventories	105,174	(118,859)
Other current assets	(92,227)	(120,314)
Increase (decrease) in liabilities:		
Accounts payable	(222,686)	827,281
Cost report settlements payable	(124,601)	(426,198)
Accrued liabilities	(396,819)	(26,282)
Net cash provided by operating activities	<u>\$ 407,702</u>	<u>\$ 2,405,210</u>

During the years ended March 31, 2004 and 2003, the Hospital recognized revenue of \$116,881 related to a deferred rental arrangement (Note 8).

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies

Reporting Entity - John Tolfree Health System Corporation (Hospital) provides inpatient and outpatient services primarily to the citizens of Ogemaw County and four adjacent counties. The Hospital is located in West Branch, Michigan. The Hospital is a municipal corporation whose board is appointed by the City Council of the City of West Branch.

The Hospital is the sole member of three related entities: Medical Arts Center (Center); Hospice of Helping Hands, Inc. (Hospice); and Tolfree Foundation (Foundation). All are not-for-profit organizations or municipal corporations and are exempt from income taxes. The Center provides mammography, ultrasound, and cardiology services to area residents. The Hospice provides home care services to the terminally ill. The Foundation engages in fund raising activities on behalf of the Hospital.

Principles of Combination - The consolidated financial statements include the accounts of John Tolfree Health System Corporation and its subsidiaries (collectively referred to as the "Corporation"): Medical Arts Center; Hospice of Helping Hands, Inc.; and Tolfree Foundation. All material intercompany balances and transactions have been eliminated.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued June 1999. The Corporation now follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provides a comprehensive one-line look at the Corporation's financial activities. There was no impact to the net assets of the Corporation in adopting GASB No. 34. No component units are required to be reported in the Corporation's financial statements and the Hospital has not elected to apply provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB).

Proprietary Fund Accounting - The Corporation utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the full accrual basis. Substantially all revenue and expenses are subject to accrual.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

Investments - Investments are stated at market, plus accrued interest.

Inventories - Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Assets Limited as to Use - Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets held by trustees in accordance with debt arrangements.

Property and Equipment - Property and equipment acquisitions are recorded at cost. Donations of property and equipment are recorded at fair market value at the date of donation. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

Deferred Charges - Deferred charges represent bond issue costs that are being amortized over the period the respective bonds are outstanding using the interest method.

Net Assets - Net assets of the Hospital are classified in two components. Net assets invested in capital assets - net of related debt, consist of capital assets net of accumulated depreciation and are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets - net of related debt.

Statement of Revenue and Expenses - For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as gains and losses.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined (Note 4).

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements

March 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Compensated Absences - Vacation and sick pay are charged to operations when earned. Unused and earned benefits are recorded as a current liability in the financial statements.

Pension Plan - The Hospital has a defined benefit pension plan covering all employees who work at least 1,000 hours a year after 30 months of service. The Hospital's funding policy is to contribute the amount necessary to provide assets sufficient to meet the benefits of plan participants, as determined by an independent actuary.

Professional Liability Insurance - The Hospital accrues the ultimate expense, including litigation and settlement expense, for incidents occurring during the year, as well as the estimate of those claims that have not been reported at year end (Note 10).

Charity Care - The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care amounts to less than one percent of patients served.

Tax Status - The Corporation is tax exempt under the Internal Revenue Code, and, accordingly, no tax provision is reflected in the financial statements.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 2 – Deposits and Investments

The Corporation's deposits and investments are included in the balance sheets under the following classifications:

	2004	2003
Cash and cash equivalents	\$ 2,693,834	\$ 1,770,963
Assets limited as to use	7,827,598	10,583,019
Total	<u>\$ 10,521,432</u>	<u>\$ 12,353,982</u>
	2004	2003
Bank deposits	\$ 7,840,296	\$ 9,707,731
Investments	2,680,206	2,645,571
Petty cash and cash on hand	930	680
Total	<u>\$ 10,521,432</u>	<u>\$ 12,353,982</u>

Deposits - The above deposits, including certificates of deposit, were reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) at \$8,350,291 and \$10,170,652 at March 31, 2004 and 2003, respectively. Of these amounts, \$978,985 and \$1,161,564 were covered by federal depository insurance and the remaining amounts were uninsured and uncollateralized for the years ended March 31, 2004 and 2003, respectively.

The Corporation believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits.

As a result, the Corporation evaluates each financial institution with which it deposits Corporation funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Investments - The Corporation is authorized under the laws of the State of Michigan to invest surplus monies (of nonpension funds) in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers acceptances, mutual funds and investment pools that are composed of authorized investment vehicles.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 2 – Deposits and Investments (Continued)

All of the Corporation's investments are categorized as Risk Category 1. Risk Category 1 includes investments that meet any one of the following criteria:

- a. Insured
- b. Registered
- c. Held by the Corporation or its agent

Risk Categories 2 and 3 include investments that are neither insured or registered. Category 2 includes investments that are held by the counterparty's trust department (or agent) in the Corporation's name. Category 3 includes investments held by:

- a. The counterparty or
- b. The counterparty's trust department (or agency) but not in the Corporation's name

2004				
Category				Current Value
	1	2	3	
U.S. government obligations	\$ 1,221,974	\$ -	\$ -	\$ 1,221,974
Bank management pool	-	-	-	1,458,232
Total investments	<u>\$ 1,221,974</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,680,206</u>

2003				
Category				Current Value
	1	2	3	
U.S. government obligations	\$ 1,221,974	\$ -	\$ -	\$ 1,221,974
Bank management pool	-	-	-	1,423,597
Total investments	<u>\$ 1,221,974</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,645,571</u>

The bank investment pools are not categorized because they are not evidenced by securities that exist in physical or book entry form. Management believes the investments in the funds comply with the investment authority noted above. The bank investment pools are regulated by the Michigan Banking Act.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 3 – Accounts Receivable

The detail of accounts receivable is presented below:

	2004	2003
Patient accounts receivable	\$ 13,830,886	\$ 12,852,967
Allowance for uncollectible accounts	(2,220,543)	(2,573,343)
Allowance for contractual adjustments and interim payment advances	(7,374,543)	(7,826,413)
Patient accounts receivable, net	4,235,800	2,453,211
Other accounts receivable	111,355	223,712
Total accounts receivable	<u>\$ 4,347,155</u>	<u>\$ 2,676,923</u>

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible. The allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors using current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

The Corporation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

The mix of receivables from patients and third-party payors was as follows:

	2004	2003
Medicare	38%	37%
Medicaid	18%	15%
Blue Cross	17%	20%
Commercial	14%	10%
Patients	13%	18%
Total	<u>100%</u>	<u>100%</u>

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 4 – Cost Report Settlements

The Corporation has agreements with third-party payors that provide for reimbursement to the Corporation at amounts different from its established rates. A summary of the basis of reimbursement is as follows:

Medicare - Inpatient acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All outpatient services are paid based on an established fee-for-service methodology subject to hold-harmless provisions.

Medicaid - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on an established fee-for-service methodology.

Blue Cross - Inpatient, acute-care services rendered to Blue Cross subscribers are also paid at prospectively determined rates per discharge. Outpatient services are reimbursed on an established fee-for-service methodology.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 5 – Assets Limited as to Use

The details of assets limited as to use are as follows:

	2004	2003
By Board of Trustees for replacement, improvement, and expansion of tangible facilities:		
Savings accounts	\$ 2,532,564	\$ 3,542,488
Mutual funds	1,458,232	1,423,597
Certificates of deposit	1,497,248	4,291,556
Accrued interest receivable	43,060	15,336
 Total board designated assets	 5,531,104	 9,272,977
 Bond indenture assets (Note 7) held by bank trust department:		
Money market funds	1,117,580	103,404
U.S. government obligations	1,221,974	1,221,974
 Total bond indenture assets	 2,339,554	 1,325,378
 Total assets limited as to use	 \$ 7,870,658	 \$ 10,598,355

Assets held under the bond indenture agreements are composed of debt service funds.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 6 – Property and Equipment

Capital asset activity for the year ended March 31, 2004 was as follows:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life-Years
Land and land improvements	\$ 751,075	\$ 365,571	\$ 82,461	\$ (3,000)	\$ 1,196,107	5 - 25
Building	19,162,832	1,780	574,093	(348,253)	19,390,452	9 - 40
Equipment	19,610,220	237,409	2,298,753	(2,278,746)	19,867,636	3 - 25
Construction in progress	2,558,948	496,970	(2,955,307)	-	100,611	-
Total	42,083,075	1,101,730	-	(2,629,999)	40,554,806	
Less accumulated depreciation:						
Land and land improvements	218,999	17,858	-	(3,000)	233,857	
Building	3,126,023	861,310	-	(348,253)	3,639,080	
Equipment	7,647,765	1,738,188	-	(2,278,746)	7,107,207	
Total	10,992,787	2,617,356	-	(2,629,999)	10,980,144	
Net carrying amount	\$ 31,090,288	\$ (1,515,626)	\$ -	\$ -	\$ 29,574,662	

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 6 - Property and Equipment (Continued)

Capital asset activity for the year ended March 31, 2003 was as follows:

	2002	Additions	Transfers	Retirements	2003	Depreciable Life-Years
Land and land improvements	\$ 718,603	\$ 33,730	\$ -	\$ (1,258)	\$ 751,075	5 - 25
Building	19,085,581	55,790	49,868	(28,407)	19,162,832	9 - 40
Equipment	19,140,078	547,049	521,352	(598,259)	19,610,220	3 - 25
Construction in progress	1,817,475	1,317,669	(571,220)	(4,976)	2,558,948	-
Total	40,761,737	1,954,238	-	(632,900)	42,083,075	
Less accumulated depreciation:						
Land and land improvements	156,773	63,484	-	(1,258)	218,999	
Building	2,542,805	611,625	-	(28,407)	3,126,023	
Equipment	6,320,685	1,930,315	-	(603,235)	7,647,765	
Total	9,020,263	2,605,424	-	(632,900)	10,992,787	
Net carrying amount	\$ 31,741,474	\$ (651,186)	\$ -	\$ -	\$ 31,090,288	

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 7 – Long-Term Debt

Long-term liability activity for the year ended March 31, 2004 was as follows:

	2003	Current Year Additions	Current Year Reductions	2004	Current Portion
Bonds payable	\$ 14,380,000	\$ -	\$ 375,000	\$ 14,005,000	\$ 395,000
Loan payable	3,699,979	-	82,027	3,617,952	90,533
Note payable	1,192,063	-	52,808	1,139,255	66,558
Total	<u>\$ 19,272,042</u>	<u>\$ -</u>	<u>\$ 509,835</u>	<u>\$ 18,762,207</u>	<u>\$ 552,091</u>

Long-term liability activity for the year ended March 31, 2003 was as follows:

	2002	Current Year Additions	Current Year Reductions	2003	Current Portion
Bonds payable	\$ 14,740,000	\$ -	\$ 360,000	\$ 14,380,000	\$ 375,000
Loan payable	3,777,185	-	77,206	3,699,979	82,027
Note payable	1,227,343	-	35,280	1,192,063	38,434
Total	<u>\$ 19,744,528</u>	<u>\$ -</u>	<u>\$ 472,486</u>	<u>\$ 19,272,042</u>	<u>\$ 495,461</u>

- Mortgage revenue and refunding bonds payable bear interest at fixed rates that vary from 5.25% to 6%. These bonds are collateralized by virtually all assets of the Hospital. The bonds are due in annual installments ranging from \$395,000 to \$1,145,000.
- Loan payable bears interest at a fixed rate of 4.5%, collateralized by virtually all assets of the Hospital and due in monthly installments of \$20,467, including interest.
- Note payable to bank bears interest at a fixed rate of 3.5%, collateralized by real estate of the Corporation. This loan is due in monthly installments of \$8,775 including interest. Any remaining balance is due in March 2008.

In connection with the bond issues, the Hospital has agreed to various covenants. These covenants include restrictions on additional indebtedness, transfer of assets and maintenance of certain financial ratios.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 7 – Long-Term Debt (Continued)

The following is a schedule by years of bond principal and interest as of March 31, 2004:

	Principal	Interest
2005	\$ 545,705	\$ 1,024,900
2006	571,939	997,929
2007	603,433	969,439
2008	1,483,680	938,692
2009	585,709	877,858
2010 - 2014	3,447,342	3,856,270
2015 - 2019	4,552,714	2,756,487
2020 - 2024	6,019,689	1,280,011
2025 and after	951,996	97,869
Total payments	<u>\$ 18,762,207</u>	<u>\$12,799,455</u>

Note 8 – Deferred Revenue

Deferred revenue relates to a prepaid lease from an area hospital for partial use of a building attached to the Hospital. Under terms of the agreement, the lessee paid for a majority of the construction cost of the building, which the Corporation owns. In exchange, the Corporation issued a 40 year lease. Under terms of the lease agreement, the lessee makes no payments for rental of the building, although payments are made to the Corporation for certain operating costs of the building, such as housekeeping, utilities, and maintenance.

During the years ended March 31, 2004 and 2003, the Hospital recognized \$116,881 in rental income.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 9 – Pension Plans

Plan Description - The Corporation maintains a defined benefit retirement plan for all employees who work at least 1,000 hours per year after 30 months of service. Participants under the plan become fully vested after five years of credited service. The plan provides retirement benefits, as well as death and disability benefits. At April 1, 2003, the date of the most recent actuarial valuation, membership consisted of 33 retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them, and 250 current active employees. The plan does not issue a separate financial report.

Funding Policy - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings. There are no employee contributions.

Annual Pension Cost - For the years ended March 31, 2004 and 2003, the Corporation's annual pension cost of \$754,320 and \$528,440, respectively, for the plan was equal to the Hospital's required and actual contribution. The annual required contribution was determined as part of an actuarial valuation of the plan as of April 1, 2003 using the entry age normal cost method. Significant actuarial assumptions used in determining the pension benefit obligation include: (a) a rate of return on the investment of present and future assets of 7 percent per year compounded annually as of April 1, 2003 and 2002 and (b) projected salary increases of 3.5 percent per year compounded annually as of April 1, 2003 and 2002. The unfunded actuarial liability is being amortized as a level percentage of payroll on an open and closed basis. The remaining amortization period is 23 years.

John Tolfree Health System Corporation and Subsidiaries

Notes to Consolidated Financial Statements March 31, 2004 and 2003

Note 9 – Pension Plans (Continued)

Three-year trend information:

	Year Ended March 31			
	2004	2003	2002	2001
Annual pension costs	754,320	\$ 528,440	\$ 554,817	\$ 464,856
Percent of APC contributed	100%	100%	100%	100%
Actuarial value of assets	*	6,478,384	7,063,100	6,624,908
Actuarial accrued liability (entry age)	*	10,251,206	8,992,523	8,835,715
Unfunded AAL	*	3,772,822	1,929,423	2,210,807
Funded ratio	*	63%	79%	75%
Covered payroll	*	8,424,636	7,304,176	7,496,142
UAAL as a percentage of covered payroll	*	45%	26%	29%

* Information not available

Note 10 – Risk Management

The Corporation is exposed to various risks of loss related to property loss, errors and omissions, employee injuries (workers' compensation) and professional liability claims as well as medical benefits provided to employees. The Corporation has purchased commercial insurance for the above claims. Settled claims relating to commercial insurance have not exceeded the amount of insurance in any of the past three years.

The Corporation is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. The Corporation bears the risk of the ultimate costs of any individual claims exceeding the policy limits for claims asserted in the policy year. For this contingency, the Corporation has accrued a liability of \$46,882 and \$121,173 at March 31, 2004 and 2003, respectively. The Corporation charged \$0 and \$50,000 against operations during the years ended March 31, 2004 and 2003, respectively.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

Additional Information

Board of Trustees

John Tolfree Health System Corporation and Subsidiaries

We have audited the consolidated financial statements of John Tolfree Health System Corporation and Subsidiaries for the years ended March 31, 2004 and 2003. Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities. The consolidating information has been subjected to the procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Plante & Moran, PLLC

June 8, 2004

John Tolfree Health System Corporation and Subsidiaries

Consolidating Schedule of Balance Sheet Information March 31, 2004 (with Comparative Totals for March 31, 2003)

	John Tolfree Health System Corporation	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation	Eliminations	Consolidated Balance	March 31, 2003 Consolidated
Assets							
Current Assets							
Cash and cash equivalents	\$ 2,224,343	\$ 342,577	\$ 78,769	\$ 48,145	\$ -	\$ 2,693,834	\$ 1,770,963
Accounts receivable	3,864,219	257,052	225,884	-	-	4,347,155	2,676,923
Cost report settlements receivable	632,400	-	-	-	-	632,400	750,000
Due from affiliates	328,816	29,060	-	-	(357,876)	-	-
Inventories	1,004,535	-	-	-	-	1,004,535	1,109,709
Other current assets	903,156	44,063	3,707	9,217	-	960,143	867,916
Total current assets	8,957,469	672,752	308,360	57,362	(357,876)	9,638,067	7,175,511
Assets Limited as to Use							
Property and Equipment	5,850,548	791,325	-	1,228,785	-	7,870,658	10,598,355
Deferred Charges	20,133,678	9,359,454	1,422	80,108	-	29,574,662	31,090,288
	318,846	-	-	-	-	318,846	335,197
Total assets	\$ 35,260,541	\$ 10,823,531	\$ 309,782	\$ 1,366,255	\$ (357,876)	\$ 47,402,233	\$ 49,199,351
Liabilities and Fund Balance							
Current Liabilities							
Current portion of long-term debt	\$ 485,533	\$ 66,558	\$ -	\$ -	\$ -	\$ 552,091	\$ 495,461
Accounts payable	1,422,423	37,527	28,247	-	-	1,488,197	1,710,883
Cost report settlements payable	-	-	-	-	-	-	124,601
Due to affiliates	29,060	118,516	204,082	6,218	(357,876)	-	-
Accrued expenses	1,434,787	-	20,422	-	-	1,455,209	1,852,825
Total current liabilities	3,371,803	222,601	252,751	6,218	(357,876)	3,495,497	4,183,770
Deferred Revenue							
	-	4,110,332	-	-	-	4,110,332	4,227,213
Long-Term Debt							
	17,137,418	1,072,698	-	-	-	18,210,116	18,776,581
Total liabilities	20,509,221	5,405,631	252,751	6,218	(357,876)	25,815,945	27,187,564
Net Assets							
Invested in capital assets - Net of related debt	2,510,727	8,220,198	1,422	80,108	-	10,812,455	11,818,246
Unrestricted	12,240,593	(2,802,298)	55,609	1,279,929	-	10,773,833	10,193,541
Total net assets	14,751,320	5,417,900	57,031	1,360,037	-	21,586,288	22,011,787
Total liabilities and net assets	\$ 35,260,541	\$ 10,823,531	\$ 309,782	\$ 1,366,255	\$ (357,876)	\$ 47,402,233	\$ 49,199,351

John Tolfree Health System Corporation and Subsidiaries

Consolidating Schedule of Revenue and Expenses and Changes in Net Assets Year Ended March 31, 2004 (with Comparative Totals for March 31, 2003)

	John Tolfree Health System Corporation	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation	Eliminations	Consolidated Balance	March 31, 2003 Consolidated
Operating Revenue							
Net patient service revenue	\$ 33,412,854	\$ 1,063,225	\$ 990,524	\$ -	\$ (392,010)	\$ 35,074,593	\$ 33,381,271
Other operating revenue	1,191,098	1,343,673	-	159,917	(255,809)	2,438,879	1,912,607
Total operating revenue	34,603,952	2,406,898	990,524	159,917	(647,819)	37,513,472	35,293,878
Operating Expenses							
Salaries and wages	11,787,583	523,322	426,959	19,564	-	12,757,428	11,999,646
Fringe benefits	3,419,746	152,915	121,131	5,717	-	3,699,509	3,383,253
Supplies and other	10,118,057	500,347	370,024	29,367	(255,809)	10,761,986	10,992,185
Drugs	5,130,361	-	101,667	-	-	5,232,028	3,936,931
Professional fees	2,029,015	448,048	32,878	-	(392,010)	2,117,931	2,414,050
Depreciation and amortization	2,141,044	491,201	912	550	-	2,633,707	2,621,776
Total operating expenses	34,625,806	2,115,833	1,053,571	55,198	(647,819)	37,202,589	35,347,841
Income (Loss) from Operations	(21,854)	291,065	(63,047)	104,719	-	310,883	(53,963)
Nonoperating Revenue (Expenses)							
Unrestricted donations	-	-	82,884	-	-	82,884	94,601
Investment income	215,899	13,906	464	-	-	230,269	333,416
Interest expense	(997,043)	(52,492)	-	-	-	(1,049,535)	(1,090,494)
Net nonoperating revenue (expenses)	(781,144)	(38,586)	83,348	-	-	(736,382)	(662,477)
Increase (Decrease) in Net Assets	(802,998)	252,479	20,301	104,719	-	(425,499)	(716,440)
Net Assets - Beginning of year	15,554,318	5,165,421	36,730	1,255,318	-	22,011,787	22,728,227
Net Assets - End of year	\$ 14,751,320	\$ 5,417,900	\$ 57,031	\$ 1,360,037	\$ -	\$ 21,586,288	\$ 22,011,787

**Report Letter on Compliance with Laws and Regulations and Internal Control
Over Financial Reporting Based on an Audit of Financial Statements Performed
In Accordance with Government Auditing Standards**

Board of Trustees

John Tolfree Health System Corporation and Subsidiaries

We have audited the financial statements of John Tolfree Health System Corporation and Subsidiaries as of and for the year ended March 31, 2004, and have issued our report thereon, dated June 8, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether John Tolfree Health System Corporation and Subsidiaries financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered John Tolfree Health System Corporation and Subsidiaries internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Board of Trustees
John Tolfree Health System Corporation and Subsidiaries

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of John Tolfree Health System Corporation and Subsidiaries in a separate letter dated June 8, 2004.

This report is solely intended for the information and use of the Board of Trustees, management, and federal awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Plante & Moran, PLLC

June 8, 2004